

THE COUNSELOR
DEPARTMENT OF STATE
WASHINGTON

October 29, 1982

TO: Members of the Alternative Energy Group
FROM: James L. Buckley *JS*

Attached please find the draft report of the Group on International Measures in Support of Energy Alternatives for Western Europe. This report was prepared by the staff working group on the basis of the discussions at our last meeting October 7, and the annex was prepared by the CIA.

My last day of duty here at the State Department has arrived. Unfortunately, it has not been possible for me to have a meeting today as planned because so many of you are out of town. This is regrettable, as I hoped to say goodbye officially to each of you. Secretary Shultz has asked Allen Wallis to take over the reins of the Group to continue the task of fostering Western alternatives to greater energy dependence on the Soviet Union. I am sure that the Group will prosper under his Chairmanship.

Please accept my best wishes and sincere thanks for your support and counsel over the last few months. Allen Wallis' office will be in touch with you about scheduling the next meeting.

Attachment:

As stated.

State Dept. review completed

Drafted: NSC:WMartin *CR10-*
CRI:A-3

Cleared: EB:RMorris *CR1-*
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SECRETReport of the Alternative Energy Group
International MeasuresIntroduction

The senior interagency Alternative Energy Group has examined the prospects for accelerated development of Western alternatives to greater energy dependence on the Soviet Union. A first report of the Group identified a series of domestic measures which a majority of the participants felt would enhance U.S. credibility as a reliable and long-term energy supplier to Europe and Japan.

This report presents a companion foreign policy strategy for encouraging international development of secure non-Soviet energy alternatives for Europe. (An NSC-led ad hoc interagency group is to examine issues related to Japanese energy dependence separately.) An annex to this report includes a fuller discussion of alternatives to Soviet gas and scenarios of future European gas supply and demand.

Continuing Soviet Market Threat

~~In examining potential European natural gas supply and demand scenarios, the Group placed particular emphasis on~~
the potential ability of the Soviet Union to supply additional European gas requirements through the mid 1990's. The Soviets could do so by use of the uncommitted capacity of the Siberian pipeline (9-10 bcm/yr after 1988 if Italy does not purchase the

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gas the Soviets had planned to sell it) together with excess capacity existing elsewhere in the growing Soviet domestic pipeline grid. Over the longer term, the Soviets will probably seek European agreement to construct a "second-strand" pipeline to increase gas delivery capability further.

The Soviet Union may be expected to be aggressive in seeking Western customers for this gas, by continuing to offer low prices and lucrative equipment sales contracts. By undercutting the market for economically scaled projects, additional Soviet sales of gas at competitive prices would preempt development of large-scale alternatives, in particular the early development of the Norwegian Troll Field (see scenarios in the annex). To the Russians, these sales would serve to compensate for the expected fall in Soviet oil and petroleum product exports during the 1980's.

In light of these circumstances, the Group concluded that the principal U.S. objective should be to increase European energy security by minimizing Soviet gas deliveries in the 1990's and encouraging economically viable alternative sources to meet incremental European gas demand in the long-term. To this end, the Group recommends the following strategy.

Recommended International Strategy

1. Limitation of Soviet Gas Purchases. In light of the continuing Soviet market threat, the Group stressed the importance of efforts to have European governments agree [to keep to a minimum imports of Soviet gas in order to ensure

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market share for large-scale economic alternatives.] [not to commit to any major incremental deliveries of Soviet gas beyond the amounts presently contracted for or in advanced stages of negotiations.] The Group recognized that discussions aimed at neutralizing the Soviet market threat are advancing in other fora, but recommended that, from the point of view of promoting alternatives, understandings on this point be as specific and effective as possible.

2. Encourage European Gas Security and Quantify Full Cost of Soviet Gas. In order to influence European attitudes in assessing Soviet versus non-Soviet gas supplies, the U.S. should support a serious effort to quantify the "full cost" of Soviet gas, including such externalities as the cost of prudent security measures, the cost of credit subsidies adjusted for the market value of equipment sold, and the macroeconomic consequences of a Soviet cutoff of gas. As part of this effort, the U.S. should actively support the IEA Natural Gas Security Study designed to identify needed security measures. The USG should also develop and disseminate ~~independent estimates of the full cost of Soviet gas. This~~ information should also be shared with European gas consumers and potential gas suppliers Norway, Nigeria and Turkey.

3. Multilateral Effort to Stimulate Economically Viable Alternatives. The U.S. should join in a major effort to utilize the IEA as a forum for examining energy alternatives for Europe. The IEA can build upon the 1982 Ministerial agreement that "further attention should be

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given to a number of options which exist to encourage stable and reliable natural gas trade ...", including "the timely development of indigenous IEA sources." The IEA is a particularly effective instrument for focussing on governmental policies that impede timely development of gas resources (such as price controls, depletion policies, leasing practices, tax regimes and non-market policies). As the IEA begins work in this area, NATO in particular should be kept apprised, as we may wish to involve NATO more directly after the comparative economics of alternative sources are known.

4. Continue to work to encourage commercial agreement to develop alternatives, particularly the Troll field in Norway. The Group recommends that Ambassador Galbraith's efforts to encourage commercial plans for Norwegian gas development continue. As commercial plans proceed, the Group may wish to make further recommendations should governmental involvement be necessary to ensure that particular, high priority alternatives proceed.

Next Steps and Further Work

The Group provided guidance on the importance of the IEA as a forum for multilateral action on alternatives directly to the U.S. delegation to the IEA Governing Board meeting October 26. Based on the outcome of that meeting and subsequent IEA work, the U.S. should take steps to make this topic an important item for IEA Ministerial discussion in the Spring of 1983, and possibly at the U.S.-hosted Economic Summit as well.

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The Group requests that the CIA and State Department continue to keep it apprised of important developments in energy alternatives. The CIA in particular should continue its work on refining scenarios for European gas supply and demand.

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